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U.S. Corn Sweeteners and Mexican Sugar: Agreement at Last!

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Access *of U.S. Corn Sweeteners to Mexico: The WTO Ruling*

The long-standing bilateral dispute over U.S. access to Mexico's corn sweetener market passed through an important phase during 2005, and was finally resolved in July, 2006. In October 2005, a WTO dispute Panel issued its determination supporting the United States on all its major claims against a 20-percent tax Mexico levies on beverages that are made with sweeteners other than cane sugar, including high-fructose corn syrup (HFCS) [WTO 2005; USTR 2005]. These taxes are aimed mainly at imports of HFCS from the United States, the primary supplier of most non-sugar sweeteners used by the Mexican beverage industry. Mexico produces little HFCS compared to its production of cane sugar. Virtually all cane sugar contained in Mexican beverages is produced domestically.

The WTO Panel determined that the Mexican beverage tax discriminates against HFCS imported from the United States. The tax is imposed on the distribution and sale of beverages that contain non-sugar sweeteners,[3] that are directly competitive with such beverages containing sugar. It is not imposed on those beverages that contain cane sugar, because cane sugar is supplied domestically. The Panel concluded that such discrimination violated Article III:2 of the General Agreement on Tariffs and Trade

[1] The opinions and conclusions contained in this article are those of the author and not of the Commission as a whole or any individual Commissioner.

[2] Please forward comments to Justino De La Cruz as Magda Kornis retired from the Agency on January 3, 2007.

[3] The tax is imposed on the commissioning, mediation, agency, representation, brokerage, consignment, and distribution of soft/drinks and beverages using sweeteners other than cane sugar.

(GATT) of 1994, which prohibits discriminatory taxes.[4] The Panel also stated that bookkeeping practices, as imposed on imported sweeteners, were not consistent with GATT Article III:4.[5]

Notably, the WTO Panel rejected Mexico's request that it leave jurisdiction in this case to a North American Free Trade Agreement (NAFTA) dispute settlement Panel, stating that WTO Panels may not decline to exercise jurisdiction over any dispute properly brought before them. Despite the WTO ruling, the Mexican legislature approved a one-year extension of the controversial tax in November 2005.

In December 2005, Mexico informed the WTO that it would appeal the Panel's ruling on grounds of an exception provided by GATT Article XX(d).[6] Mexico explained that its tax on sweetners was needed to secure U.S. compliance with NAFTA in granting access for Mexican sugar to the U.S. market, discussed in more detail below. However, the Appellate Body disagreed with the applicability of GATT Article XX(d) to Mexico's defense, and the appeal was rejected in March 2006 [USTR 2006(a)]. The DSB adopted the Appellate Body report and the Panel report on March 24, 2006.[7]

Coinciding with these developments in the WTO, changes in the supply of and demand for all sweeteners, including sugar in both countries provided an impetus to resolution of the sweetener dispute. Agreement was reached on July 27, 2006, calling for the termination of the tax on HFCS, well before January 1, 2008 – the date slated by NAFTA for free trade in sweeteners. The Mexican Government repealed this tax on January 1, 2007.

Background

Mexico imposed the beverage tax in question in January 1, 2002, levying it on soft drinks and other beverages (as well as on syrups and other products that can be diluted to produce soft drinks and beverages) using corn sweeteners. Although the tax had been temporarily suspended by the Fox Administration, the Mexican Supreme Court

[4] Article III:2 provides that "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products."

[5] Article III:4 provides that "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect to all laws and regulations, and requirements affecting their international sale, offering for sale, purchase, transportation, distribution, or use."

[6] Article XX sets out grounds for exceptions to GATT standards. Section (d) in particular states: necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices.

[7] See, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds308_e.htm.

ruled the suspension unconstitutional and reinstated the tax in July 2002. In March 2004, the United States requested consultations under WTO dispute settlement procedures, and in July 2004, a WTO Panel was established to review the dispute. Following the 2002 Supreme Court ruling, the Mexican Government renewed the tax each year – even in 2005, after the WTO determination against it earlier in the year [*Inside U.S. Trade* 2005].

Levying this tax was the Mexican Government's most recent act in its quest to reverse a shift towards the use of HFCS from domestic sugar in beverages and processed foods. Concerned about Mexico's sugar surplus and limited access to the U.S. sugar market, Mexican authorities took measures to restrict the use of cheaper HFCS in these products.

The imposition of the beverage tax had been preceded by lengthy Mexican antidumping action against HFCS imports from the United States. Such action began in 1997; as with the beverage tax, it was also subject to U.S. challenge in the WTO. In February 2000, the WTO's Dispute Settlement Body (DSB) adopted a panel report concluding Mexico's antidumping duties on U.S. sweeteners were not in accordance with the WTO Antidumping Agreement. Mexico then issued a new determination justifying imposition of antidumping duties on U.S. sweetners. The United States challenged the new Mexico determination as inconsistent with the DSB's prior action. A dispute settlement panel and the WTO Appellate Body agreed. In November 2001, the DSB adopted a report that Mexico's new determination was also inconsistent with the WTO Antidumping Agreement.

The Government of Mexico was prompted by the failure of its antidumping action to turn to an alternative way of impeding imports of U.S. corn sweeteners – the beverage tax. The antidumping duties were removed in May 2002, and the beverage tax was imposed earlier, in January 2002.

The table and figure below show the effects of the antidumping action on U.S. exports to Mexico of HFCS 55[8] and HFCS 90 (both included in HTS subheading 1702.60) during 1997-2001, as well as the effects of the tax on U.S. exports to Mexico of beverages containing such sweeteners during 2001-2005.

Beginning in 1997, when Mexico started its antidumping action against U.S. corn sweeteners, U.S. exports to Mexico of HFCS 55 and HFCS 90 began to decline. The decline accelerated sharply following the imposition of the beverage tax in January 2002. In 2002, U.S. exports to Mexico dropped by two thirds compared with 2001. Mexico's share of total U.S. exports dropped from 63 percent in 1997 to 41 percent in 2001, while dumping duties were in effect. Thereafter, the tax rendered the use of HFCS in soft drinks and syrups cost-prohibitive for Mexican producers, and U.S. exports were at relatively low levels in 2002, 2003, and 2004. Mexico dropped to the

[8] HFCS 55 is one of the most commonly produced and traded non-sugar sweeteners.

fifth-largest destination of U.S. corn sweeteners after Canada, China, Thailand, and Japan. Notably, U.S. exports to Mexico rebounded in 2005 for reasons that will be discussed later.

The table and chart also show that the virtual loss of the Mexican market significantly affected total U.S. exports of HFCS. Such exports have remained well below their peak reached in 1998, even though they strengthened to some other markets.

Table 1 HTS–1702.60: Fructose and fructose syrup containing in the dry state more than 50 percent by weight of fructose, U.S. domestic exports, annual, 1997-2005

(1,000 dollars)

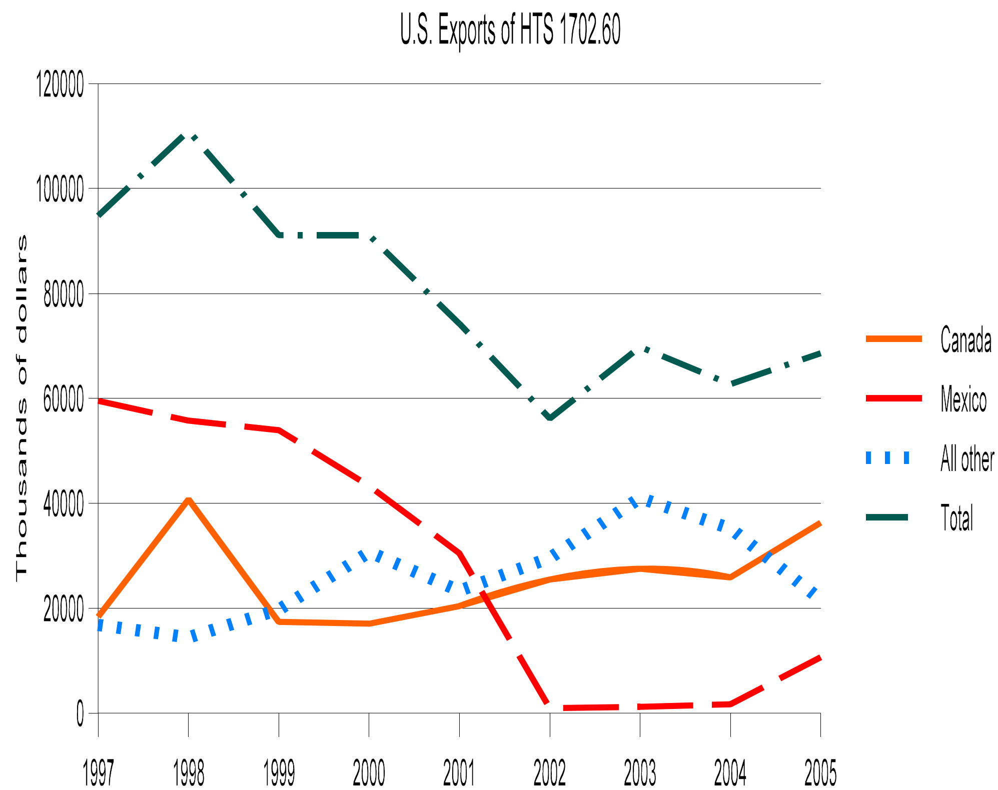
Country	1997	1998	1999	2000	2001	2002	2003	2004	2005	Percent Change 2004/ 2005
Canada	18,394	40,804	17,426	17,054	20,406	25,496	27,532	25,853	36,301	40.4
Mexico	59,585	55,764	53,921	43,333	30,490	965	1,232	1,691	10,645	529.7
All other	16,828	14,438	19,752	30,741	23,356	29,593	41,053	35,189	21,655	-38.5
Total	94,807	111,006	91,099	91,128	74,252	56,154	69,817	62,733	68,601	9.4

Source: Compiled from official statistics of the U.S. Department of Commerce.

Canada has been the leading destination since 1998. U.S. corn refiners producing HFCS repeatedly complained about suffering heavy losses from Mexico's efforts to block their exports, prompting U.S. authorities to initiate WTO dispute settlement procedures (Corn Refiners Association 2005).

Access of Mexican Sugar to the United States

The dispute over U.S. access to Mexico for HFCS was spawned by Mexico's dissatisfaction with its own access for sugar to the United States. Since the inception of NAFTA in 1994, U.S. imports of sugar from Mexico – raw and refined sugar – have been small compared with imports from some other countries in accordance with pre-



NAFTA patterns of U.S. imports by supplier.[9] During most of this period, Mexico accounted for only 1 to 6 percent by value of all US. sugar imports. In 2005, however, Mexico's share of U.S. imports rebounded from 3.7 percent in 2004 to 14.8 percent of total U.S. imports as Mexico moved up to become the second-ranking U.S. sugar supplier after Brazil. That year, with its soaring sugar exports to the United States, Mexico outranked other U.S. suppliers who were leading in 2003 and 2004, such as Guatemala, the Dominican Republic, and the Philippines. The reasons for this will be discussed later in this article.

Mexico believed that it should have provided a much larger portion of U.S. sugar imports during the NAFTA years, alleging that, under NAFTA, Mexican sugar surplus should have had unlimited access to the U.S. market free of duty [WTO 2005, 22]. In Mexico's view, NAFTA defines surplus as output less consumption of sugar for a given fiscal year (FY), i.e. October 1 through September 30, as provided in the initial August 1992 NAFTA agreement, signed by each country's president in late 1992.

According to the United States, a revised and now valid NAFTA provision concerning sugar trade placed more restrictions on imports of Mexican sugar allowed to enter the United States free of duty than the original NAFTA had [USDA, ERS 1999, 18]. The revised version provides that (a) Mexico's "net surplus position" (NSP) must be calculated by deducting from the country's sugar output not only its sugar consumption, but also its HFCS consumption, and that (b) in 2001-2007, duty-free entry of Mexican sugar must be capped at 250,000 metric tons raw value (MTRV), regardless of the size of Mexico's surplus. These revised NAFTA provisions are contained in the so-called "side letter" from then USTR Michael A. Kantor of Nov. 3, 1993 to Jaime Serra Puche, Mexico's then Secretary of Commerce and Industrial Development (SECOFI). The side letter was included along with other NAFTA documents submitted to the Mexican Congress with the implementing bill. All agree that under NAFTA, Mexico will have unlimited duty-free access to the U.S. sugar market beginning January 1, 2008.

Mexico has disputed the validity of the revised NAFTA provision, pointing repeatedly to U.S. noncompliance with NAFTA for not allowing all the sugar that Mexico considered "net surplus" to enter the United States free of duty. As mentioned earlier, Mexico argued before the WTO in the HFCS case that the disputed beverage tax it imposed was justified as a means of securing U.S. compliance under NAFTA with respect to sugar.

Sugar is one of the first industries developed by the Spanish colonizers in Mexico. Even though sugar has always been a major industry in the country, Mexico had been generally a net importer prior to NAFTA, because of its inefficient production and large domestic consumption. In the 1990s, Mexican sugar mills sharply increased their output, and by 1995, Mexico was not only capable of meeting domestic demand for sugar, but became

[9] The United States allocates its raw cane sugar tariff-rate quota (TRQ) to 40 quota-holding countries, based on a representative period (1975-81) during which trade had been relatively unrestricted [Haley 2001].

a sugar exporter. These positive developments resulted from privatization, technological improvements, and support by the Government of Mexico.

Like the United States, Mexico has a protected sugar market, with domestic prices generally well above world market prices, although recent conditions in the world market have narrowed the gap [U.S. Department of State 2005].[10] Since 1997, the government has determined the amount of sugar that can be marketed domestically, controlling thereby the volume to be allocated for exports and stock piling. Government support enables the domestic sugar industry to maintain both high domestic prices and high production levels.

However, despite government assistance and the resulting high domestic sales prices, several Mexican sugar mills became heavily indebted. Their productivity gains and marketing expertise were insufficient for competitiveness of Mexican sugar on world markets, especially at times when world market prices of sugar were falling. The debt load of sugar mills prompted the Administration to re-nationalize 27 out of 60 functioning sugar mills in September 2001.

Mexico's sugar growers and the Administration had been embroiled in a fight over whether direct, up-front, guaranteed government subsidies to growers should continue (as the growers wanted) or the market should be allowed to determine the prices at which cane sugar is sold to processors (as the Administration wanted) [*SourceMex Economic News & Analysis* 2005]. Arguing that subsidized, high domestic prices for sugar cane are hurting the sugar-processing industry's efforts to modernize, in January 2005, the Fox Administration withdrew an 1993 sugar decree that provided for these high subsidies. However, the Mexican Congress voted to bring back the cancelled legislation in August 2005, when a "Law on Sustainable Development" re-established the role of the Federal Government in setting guaranteed prices for sugar cane, and determining the growers' share of sugar sales revenues [Haley 2005, 2].

Recent Developments in Supply and Demand of Sweeteners and Sugar *in the United States and Mexico*

In the second half of 2005, bilateral negotiations on sweeteners reflected the changes that have taken place in both partners' sugar output, U.S. demand for sugar, and Mexican demand for corn sweeteners. The U.S. Department of Agriculture (USDA) lowered expectations of U.S. sugar production, because of hurricanes and other weather-related events in August and September. The resulting shortage of raw cane sugar and refined beet and cane sugar was exacerbated by the closure of one sugar refinery, and interruptions in the operation of another in Louisiana, due to Hurricane Katrina. USDA determined that U.S. sugar supplies might be insufficient to meet the unexpectedly high

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[10] More recently, global supply and demand conditions raised world market prices of sugar and narrowed the gap.

domestic demand in FY 2005 and FY 2006. By contrast, Mexican sugar cane production, aided by excellent weather, reached record amounts in 2005.

Because of these changes in supply and demand, the United States and Mexico took steps to restart bilateral trade in sugar and other sweeteners, separate from the WTO action. On September 30, 2005, the United States opened up the duty-free tariff-rate quota (TRQ) under NAFTA for imports of 250,000 MTRV of Mexican sugar for FY 2006, on grounds that Mexico qualified as a surplus producer [USDA, OC 2005(a)]. The United States and the Mexican Secretary of Agriculture further negotiated additional, over-quota quantities of refined sugar imports from Mexico to the United States duty-free under a global U.S. TRQ, which was established for entry under a first-come first-served basis. The purpose of this TRQ was to cover the shortfall of U.S. imports from those Central American countries that were affected by late hurricanes in 2005, and were unable to fill their TRQ for FY 2005 [USDA, OC 2005(b)]. In addition, Mexican sugar could enter the United States at relatively low duties under a declining tariff schedule established by NAFTA. As a result of these new provisions, U.S. imports of Mexican raw cane sugar increased by 723 percent and refined sugar imports increased by 1,278 percent in 2005 compared with 2004, making Mexico the number two U.S. source of sugar, after Brazil [USDA/FAS 2005(a), 3].

Mexico opened its doors to U.S. corn sweeteners, too. The Secretary of Economy (SE) announced on September 30, 2005 that, in the spirit of establishing a more amicable environment in which to resolve ongoing bilateral sweetener issues, it was prepared under certain conditions to issue import permits for up to 250,000 metric tons of corn sweeteners between October 1, 2005 through September 30, 2006 [USDA/FAS 2005(b)]. In November 2005, additional Mexican announcements specified the tariff numbers of the eligible sweeteners and the procedural requirements for issuing import permits [USDA/FAS 2005(c)].

Mexican authorities may have had another reason for reopening the Mexican market for U.S. corn sweeteners. Domestic HFCS consumption has been on the increase since late 2004, despite the authorities' efforts to induce the beverage industry to use sugar rather than corn sweeteners in its products. A growing number of beverage producers obtained "amparo"-s (court injunctions), which waive the 20-percent tax on beverages containing HFCS on a case-by-case basis.[11] While Mexican beverage producers may obtain "amparo"s for corn sweeteners from the United States or Canada, the 250,000 MT quota for U.S. imports cannot be exceeded. This development reignited Mexican demand for U.S. HFCS, since domestic capacity for producing HFCS is limited, and short-term prospects for expanding it reportedly are dim.[12]

The table and chart above show U.S. exports of HFCS to Mexico rebounding in 2005. The United States exported $10.6 million worth of HFCS-55 and HFCS-90 to Mexico

[11] While Mexican beverage producers may obtain "amparo"s for corn sweeteners from the United States or Canada, the 250,000 MT quota for U.S. imports cannot be exceeded.

[12] Data on Mexican HFCS output are not available.

compared with $1.7 million in of 2004 – an 530-percent increase. Mexico accounted for more than 15 percent of total U.S. exports in 2005, and became the second largest destination for U.S. exports after Canada, followed closely by China, which accounted for most of the rapid growth of imports in the "All Other" category of the table above.

The Agreement

The United States and Mexico thus entered the year 2006 with less tension over sugar and sweetener trade, manifest by some measure of optimism expressed by U.S. officials.[13] Yet, the 20-percent tax, ruled inconsistent with Mexico's WTO obligations by the WTO Dispute Settlement Panel, continued to be levied on soft drinks containing U.S. sweeteners to Mexico.

This issue was finally resolved on July 27, 2006, when the United States and Mexico announced the long-awaited agreement set forth in an exchange of letters between the USDA and the Mexican Ministry of the Economy. The accord includes Mexico's commitment that duties on HFCS-containing beverages will no longer be imposed after January 1, 2007, as already communicated to the WTO earlier during the month.[14] Most important, the parties provided for reciprocal duty-free import quotas on sugar and HFCS during a transitional period of October 1, 2006 through December 31, 2007, to be followed by the removal of all barriers in mutual sugar and other sweetener trade on January 1, 2008, as mandated by NAFTA [USTR 2006(b)].

Free trade in sugar and non-sugar sweeteners will, of course, raise new concerns`to be resolved; the parties liberalizing their remaining trade-distorting measures would have to face the impact of free trade on their current sugar and sweetener programs. With respect to a future U.S. program, J. B. Penn, USDA Under Secretary said:

> "The formulation of a sustainable safety net for American sugarcane and sugar beet producers in the future must consider the challenges presented by the rapidly changing domestic and international environment. Sugar program administration has become increasingly difficult within the past year and is not expected to get any easier. The development of an appropriate policy for 2008 market conditions and beyond will require foresight and innovative thinking."[15]

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[13] See for example the letter of the United States Trade Representative Robert Portman to Senator Tom Harkin, Nov. 18, 2005, and the testimony of J.B. Penn, United States Department of Agriculture, Under Secretary for Farm and Foreign Agriculture Services, before the Senate Agricultural Committee on "Review of the Implementation of the Sugar Program," May 10, 2006.

[14] On July 3, 2006, the United States and Mexico submitted a joint letter to the WTO Dispute Settlement Body, stating that they agreed on the "a reasonable time period," after which Mexico will comply with the WTO ruling [WTO 2006].

[15] Testimony of J.B. Penn, United States Department of Agriculture, Under Secretary for Farm and Foreign Agriculture Services, before the Senate Agricultural Committee on "Review of

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[15] (...continued)
the Implementation of the Sugar Program," May 10, 2006.

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